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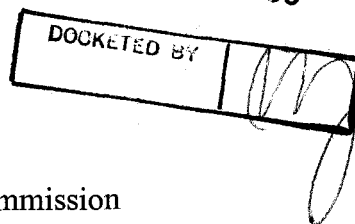
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DOCKETED

SEP 28 1998



September 25, 1998

Docket Control Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

ATTENTION: MS. CARMEN MADRID

RE: Docket No. E-01345A-98-0473

Dear Ms. Madrid:

Enclosed are the original and ten copies of PG&E Energy Services Corporation's Application to Intervene in the above referenced matter .

If you have any questions, please feel free to contact me at (520) 721-1900.

Sincerely,

Diana J. Bingham
Secretary to Lawrence V. Robertson, Jr.

Enclosures

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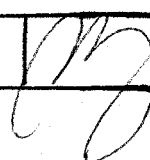
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INTERVENTION

BEFORE THE ARIZONA CORPORATION COMMISSION

JIM IRVIN
COMMISSIONER - CHAIRMAN
RENZ D. JENNINGS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

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IN THE MATTER OF THE APPLICATION) DOCKET NO. E-01345A-98-0473
OF ARIZONA PUBLIC SERVICE COMPANY)
FOR APPROVAL OF ITS PLAN FOR) PG&E ENERGY SERVICES
STRANDED COST RECOVERY) CORPORATION'S APPLICATION
FOR LEAVE TO INTERVENE

Pursuant to A.A.C. R-14-3-105 of the Commission's Rules of Practice and Procedure, PG&E Energy Services Corporation ("Energy Services") hereby makes application for leave to intervene in the above-captioned proceeding before the Commission.

I. IDENTITY OF APPLICANT

PG&E Energy Services Corporation ("Energy Services") is a national energy services company which sells commodity electric and natural gas products and customized value-added energy products and services, including energy and facilities management and power quality services. Energy Services is a wholly-owned California subsidiary of San Francisco-based PG&E Corporation. Energy Services was formed to participate in unregulated energy markets, and intends to become active in retail electric markets as those markets are opened to competition through restructuring of the electric industry.

The State of Arizona represents such a market. On December 26, 1996, the Commission

1 issued its Decision No. 59943 in Docket No. U-000-94-165. Therein, the Commission adopted
2 certain Retail Electric Competition Rules ("Rules") as an initial step in the transition towards
3 competition in certain sectors of the retail electric industry in the State of Arizona. Those Rules are
4 set forth in A.A.C. R14-2-1601 et seq. The Rules were perceived as a framework within and through
5 which the aforesaid transition would ultimately be accomplished. Additional proceedings before the
6 Commission would be necessary, as would the adoption by it of additional regulations; and that was
7 understood by all interested persons.¹

9 Energy Services, and its predecessors-in-interest, Vantus Energy Corporation and Vantus
10 Power Services, were such an "interested person." In fact, its interest was such that it actively
11 participated in the proceeding which resulted in the issuance of Decision No. 59943, as well as all
12 subsequent proceedings which have been conducted by the Commission in connection with
13 restructuring of the retail electric utility industry in Arizona. In addition, Energy Services has
14 actively participated as an Intervenor in all litigation involving Decision No. 59943.

17 In furtherance of its aforesaid corporate purposes, on November 4, 1997 Energy Services
18 filed an application with the Commission, pursuant to A.A.C. R14-2-1603, within which it requested
19 the issuance of a certificate of convenience and necessity authorizing it to provide various energy
20 services as an Electric Service Provider on a state-wide basis. On July 13, 1998, the Commission's
21 Docket Control Center assigned Energy Services' application Docket No. E-03595A-98-0389. On
22 August 14, 1998, Energy Services filed certain materials with the Commission to supplement its
23

24 _____
25 ¹
26 In its Decision No. 61071, issued August 10, 1998, the Commission adopted certain amendments to the
27 Rules on an emergency basis. However, those amendments are not material in relation to the subject
28 matter of this application.

1 previously filed application. On August 20, 1998, a Procedural Order was issued providing that the
2 public hearing on Energy Services' application would commence on October 13, 1998.
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5 **II.**
6 **NATURE OF APPLICANT'S INTEREST IN**
7 **ABOVE-CAPTIONED PROCEEDING**

8 The Application and the Plan which are the subject of the above-captioned proceeding were
9 filed by Arizona Public Service Company ("APS") pursuant to the first and second ordering
10 paragraphs of the Commission's Decision No. 60977. That opinion and order was issued on June
11 22, 1998 in what was commonly referred to as the "stranded costs" hearing. In turn, that hearing had
12 been conducted within the context of the Commission's overall retail electric competition
13 proceeding, which had been assigned Docket No. RE-00000C-94-0165. As such, it was one of the
14 additional proceedings contemplated by the Commission in Decision No. 59943 that would be
15 necessary in order to implement the framework for the transition to retail electric competition. The
16 instant proceeding represents yet another procedural iteration in the process, inasmuch as it was
17 created to address the specifics of APS's "stranded costs" proposal.
18

19 Energy Services was a party of record in the "stranded costs" hearing, and it actively
20 participated therein, presenting and cross-examining witnesses and filing an Initial Brief and a Reply
21 Brief. In addition, subsequent to APS's filing of the aforesaid Application and Plan, Energy Services
22 filed comments and disagreements with respect thereto pursuant to the third ordering paragraph of
23 Decision No. 60977. A copy of those comments and disagreements is attached hereto as Appendix
24 "A" and incorporated herein by reference.
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1 As may be noted therefrom, Energy Services has serious problems and concerns with APS's
2 proposed Plan. First, it believes that APS's proposal is in direct opposition to the "stranded costs"
3 calculation and recovery alternatives provided for by the Commission in Decision No. 60977; and
4 that it fails to comply with the requirements of that opinion and order. Second, it believes that
5 approval and implementation of APS's Plan would completely stifle competition from new entrants,
6 such as Energy Services. Third, it believes APS has substantially over-estimated its purported
7 "stranded costs" exposure, using unsupportable assumptions. Finally, APS appears to have grossly
8 misrepresented the impact of "stranded costs" recovery on its electric utility distribution operation.
9

10 Thus, Energy Services' interests as a prospective Electric Service Provider are directly and
11 substantially affected by any decision the Commission may render in response to APS's Application
12 and Plan. Moreover, there is no other person or entity who can represent Energy Services' interest
13 or express its views. It is the only prospective Electric Service Provider who has filed an application
14 for a certificate of convenience and necessity pursuant to A.A.C. R14-2-1603 which would place it
15 in competition with APS in APS's currently certificated service areas. Furthermore, Energy
16 Services' intervention would not unduly broaden the issues the Commission must necessarily
17 consider and resolve in ruling upon APS's proposal, as an examination of Energy Services' attached
18 comments and disagreements readily attests.
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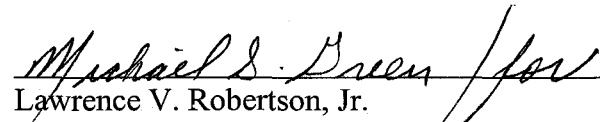
22 In view of the above, it is readily apparent that Energy Services' circumstances clearly satisfy
23 the requirements governing intervention set forth in A.A.C. R14-3-105(A) and (B).

24 WHEREFORE, in view of the preceding discussion, Energy Services (i) believes it has fully
25 satisfied the requirements governing intervention set forth in A.A.C. R14-3-105, and (ii) hereby
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requests that it be granted leave to intervene in the above-captioned proceedings with all rights of participation therein as a party of record.

DATED this 25th day of September, 1998.

Respectfully submitted,


Lawrence V. Robertson, Jr.
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Attorney for PG&E Energy Services
Corporation

Original and ten (10) copies
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day of September, 1998, with:

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Phoenix, Arizona 85007

Copies of the foregoing
mailed this 25th day of
September, 1998, to:

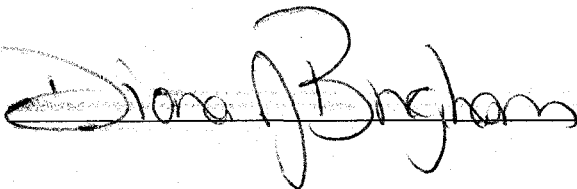
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APPENDIX "A"

BEFORE THE ARIZONA CORPORATION COMMISSION

JAMES M. IRVIN
CHAIRMAN
RENZ D. JENNINGS
COMMISSIONER
CARL J. KUNASEK
COMMISSION

IN THE MATTER OF THE COMPETITION) **DOCKET NO. RE-00000C-94-165**
IN THE PROVISION OF ELECTRIC)
SERVICES THROUGHOUT THE STATE)
OF ARIZONA)
_____)

**COMMENTS / DISAGREEMENTS
OF PG&E ENERGY SERVICES
On the stranded cost compliance filing of APS
September 21, 1998**

BACKGROUND

Commission Decision No. 60977 ordered that "all other parties shall file any comments/disagreements and requests for hearing" within 30 days of each Affected Utility's filing of its implementation plan.

PG&E Energy Services herein submits its comments / disagreements on Arizona Public Service Company's ("APS") plan for stranded cost recovery filed on August 21, 1998. We do not request a hearing, but if one is required, we desire to participate.

SUMMARY OF COMMENTS

APS has submitted a "compliance filing" that is **totally out of compliance** with the Commission's recently adopted policies on stranded cost recovery and generation divestiture as ordered in Decision No. 60977 on June 22, 1998. Energy Services requests that the Commission reject APS' "compliance filing" and order APS not to charge any APS customers taking direct access service from an energy services provider (ESP) any additional charge for stranded costs. We also request the Commission require APS to immediately re-file its unbundled direct access tariffs and fully remove embedded generation costs (a minimum of 3.69 cents per kilowatt hour before "losses" for 1999 as per APS Exhibit 2) and other competitive service costs from regulated unbundled tariffs. Should APS fail to file complying tariffs, we request the Commission itself determine and establish these tariffs before January 1, 1999.

APS rejected this Commission's Option 1, the divestiture of generation assets. Necessarily, therefore, APS must be deemed to have selected Option No. 2 – Transition Revenues Methodology. APS's filing, however, does not conform to Option 2, and either should be rejected outright, or modified by this Commission to conform with the Commission's order. APS's decision not to sell its generation assets must be viewed by the Commission as an economically rational decision. Plainly, in making such an important decision, its management must have carefully considered the potential risks and rewards and performed numerous financial analyses and "what ifs." APS obviously has concluded that retention of its generation has greater value to APS than does divestiture. The Commission provided APS a reasonable opportunity to recover 100% of its stranded costs via a divestiture program plus the Commission allowed for a shareholder incentive payment for sales proceeds above book value. APS has rejected that option. In accordance with Option 2, APS's generation assets must be presumed to have a market value at least equal to their depreciated book value, and therefore APS is deemed to have no generation—related stranded costs. It could easily be the case that APS' generation assets have a value greater than net book and, therefore, the ACC should consider terminating early APS recovery of regulatory assets in order for direct access customers not to be deprived of the stranded benefit of these assets.

In the case of APS, the Commission's course is clear. APS' retail territory should open January 1, 1999 without an additional CTC imposed on customers who elect direct access. The Commission should review this decision based on actual market results after 1999, possibly in tandem with establishing an appropriate unbundled direct access tariff before customer eligibility expands from 20% to 100% in 2001. This Commission should review APS's costs and tariffs carefully since it could very likely be the case that recovery of APS' regulatory assets should terminate prior to full recovery in 2004 in order to enforce compliance with Decision No. 60977.

APS' own estimate of unrecoverable stranded cost for the year 1999 is only \$49 million! The estimate for the year 2000 is only slightly greater at \$52 million. Even so, both of these estimates are inflated for several reasons including APS' use of artificially low market prices. APS' assumed market price of 2.63 cents per kilowatt hour will not permit Energy Services to compete under any reasonable range of existing market conditions.

APS has very likely made a wise choice for APS, but in so doing it has thumbed its nose at this Commission and erected insurmountable barriers to competition. It should now be apparent APS has **no** remaining stranded generation costs at risk in the market. The Commission's program to accelerate recovery of regulatory assets and APS' own efforts to reduce costs have achieved their intended results. APS forecasts generation costs of only 3.69 cents per kilowatt hour for 1999 in Exhibit 2. We congratulate APS on their low costs! They have reduced their embedded generation costs to levels at which they can retain many existing customers eligible for competition and also remain profitable during their very **first** year of competition.

DETAILED COMMENTS

1. APS' "compliance filing" is totally out of compliance with Decision No. 60977.

- A) APS fails to make any reasonable effort to interpret or comply with the Commission's Option No.2 – Transition Revenues Methodology. Any participant to the stranded cost docket knows this option meant that the Commission would provide, **at most**, minimal financial integrity or an allocation of stranded cost to shareholders. APS has not indicated their minimal financial integrity parameters and they have not presented sharing percentages. Decision No. 60977 (page 12, line 25) ordered APS to file "minimum financial ratios to maintain financial viability for ten years." They have not done this – a clear violation of the Order. Perhaps, APS has not provided the information required in Option No. 2 because revealing its present strong financial standing would invite parties to suggest their financial health should first deteriorate to minimal financial parameters before any CTC is established – a very lengthy proposition indeed. Thus, such information would undermine any legitimate claim for a CTC under this option for the foreseeable future. During the period that the Commission has been considering electricity competition, Pinnacle West's (parent of APS) common stock value has increased dramatically.
- B) APS includes stranded costs incurred after 1996 (see page 4, line 17) in its Market Generation Credit proposal even though the Commission decided "there does need to be a reasonable cutoff period for stranded costs and the approval date of the Electric Competition Rules is a reasonable cutoff." (page 13, lines 19 and 20.) That cutoff date was December 1996.
- C) APS continues to propose a net lost revenues mechanism in spite of the Commission's Fact Finding No. 27 in Order No. 60977: The Net Revenues Lost Methodology proposed by APS provides little incentive for customers to utilize another competitive service.

2. APS' proposed "Market Generation Credit" ("MGC") will completely stifle competition.

- A) APS' MGC grossly understates the full costs avoided by APS in not providing retail energy to a direct access customer. Indeed, all APS has done is assigned the pure wholesale commodity cost to the energy credit. Plainly, there is a spread between the wholesale commodity price and the costs of retail energy service and these costs must be recognized in the MGC or APS will have a huge competitive advantage. An ESP must recover in its electricity supply price many costs besides its generation supply costs. These include customer acquisition costs (e.g., marketing and sales), ancillary services, settlements of balancing accounts, metering, billing and collection costs (fully allocated—utilities typically argue these costs should be credited only the basis of the utility's decremental cost of the last bill not sent), contract administration costs, electronic interface costs and DASR processing costs. APS must allocate all of these costs to its energy credit. (This point can be demonstrated through reference to the stranded cost filing of Citizens Utilities also on August 21, 1998. Although that utility passes through (without mark-up) the costs of its purchase power contract with APS to its retail customers in its current prices, it wants a new entrant to take over

that same contract and guarantee a six percent price reduction to Citizens customers. How can a new entrant take over a contract that is simply a pass through under current prices and offer a 6 percent reduction? Citizens states a "new entrant would gain a beachhead to the Arizona power market through overnight access to one of Arizona's fastest-growing power markets (Mohave County)." In other words, Citizens understands that a new entrant would lose more than 6% if it wanted to attract customers in their territory under rules that are likely to prevail.)

Of critical importance is that it is insufficient for an ESP simply to offer to a potential customer a break even energy price. Experience has shown that customers will not switch unless they save money—a 10% savings on the delivered price of electricity is a good rule of thumb. This means that an ESP must not only recover all its costs in the price of its electric service—costs that are not reflected in APS's proposed MGC—it must also offer a significantly lower price than the utility in order to induce a customer to switch. The utility, with a 100% captive market (and having already incurred and recovered its acquisition costs), incurs no additional retention costs in keeping its customers if the ESP can't offer the customer savings. These savings are necessary to overcome the inherent advantage of the incumbent utility which already has the customers. Savings are also necessary to help overcome what we sincerely hope are customers misplaced concern that if they switch they will receive a lower quality of *regulated* delivery service from their local distribution utility. Customers repeatedly ask us whether service from the UDC will deteriorate in retaliation for switching. Will outage response times suffer at their sites? Will voltage problems receive prompt resolution? (One only needs to see APS' current TV and print advertising campaign to notice the not so subtle message that (only) APS customers receive reliable power.)

It is safe to say that direct access tariffs will attempt to recover sales, marketing, and other costs that are improperly allocated to non-generation functions. The Commission will need to scrutinize the Affected Utilities' tariffs carefully to ensure that all costs are properly allocated to the appropriate function, that is, the costs that are essential to distribution are allocated to distribution and that costs assignable to competitive activities are excluded from unbundled direct access tariffs.

All of the above points are legitimate issues and solving them does not "game" the system as APS alleges.

- B) As many know, a similar type of generation credit is in place in California until at least the first quarter of 2002. Switching to-date in California has been fairly minimal, particularly by residential and small commercial customers. Larger, more sophisticated customers are switching largely because of "CTC financing." Under this approach, an ESP offers power under long term contracts extending several months to a year or longer after the statutory date when the generation-related CTC charge ends. The price is typically a fixed discount in the delivered price of electricity from the tariff rate that would otherwise be applicable for utility service extending over the entire contract term, including the period when CTC recovery has

ended. This effectively brings forward for the customer during the initial four years of the contract when the CTC charge is in place some of the benefits of the lower cost of electricity when CTC's have ended. The successful marketing of this type of electricity product in APS's territory is problematic under APS's plan since customers are not likely to lock themselves into 7-8 year power supply contracts because their MGC does not expire until 2005. We must also ask, why does APS need six **more** years to recover its CTC's when its stranded costs, by even APS's calculation, are relatively low?

Fortunately, California has a number of redeeming elements to its restructuring program that helps overcome the shortcomings of that state's generation credit method. These include a substantially reduced return on equity for generation assets (90% of the embedded cost of debt), divestiture of generation assets and several new institutions intended to eliminate the utilities' market power, such as the Independent System Operator and the Power Exchange. All three of these elements are in place in California today, whereas Arizona has not ordered the first, struggles with the second and has virtually canceled one piece of the third (the ISO) before it even got off the ground and not considered the PX. Arizona's divestiture program was intended to overcome these deficiencies. There are many types of potential market power. Please don't be fooled by APS' creative ideas to solve one type of market power if they leave other potential types of market power in tact.

3. **APS has presented a stranded cost forecast for 1999 and 2000 of only \$49 million and \$52 million, in part, because customer switching is capped at only 20% of the market.**
 - A) APS stranded costs estimates in Exhibit 2 are only \$49 million and \$52 million in 1999 and 2000, respectively. It is hard to believe that there has been and continues to be so much attention surrounding an issue that represents less than 3% of APS' revenues in each of the first two years of competition. APS has successfully distracted attention away from legitimate issues needing attention.
 - B) These estimates are inflated for several reasons. First, it is apparent the Arizona market will get off to a slow start since some key details will not be available until at least December 1997. Second, there will only be a few licensed ESP's in the early months to facilitate switching. Additionally, Arizona has the most costly and time-consuming ESP licensing process of any state with retail competition rules or legislation. We believe this is a primary reason why only one ESP is seeking an Arizona license to supply electricity and over 50 ESP's are seeking licenses in Pennsylvania, yet both markets open January 1, 1999. Third, the Affected Utilities are foot dragging on proposing UDC/ESP service agreements. Fourth, retail market prices are significantly higher than they estimate in Exhibit 2. APS' market can open on January 1, 1999 with no CTC in place and they will not experience \$49 million in stranded costs.

4. APS grossly misrepresents the impact of stranded cost recovery on its distribution business unit (page 11, beginning line 9).

- A) The only reason the Commission has not been able to establish distribution tariffs that fully recover distribution costs, provide an associated return on distribution equity and permit the funding of new distribution infrastructure, is that APS has not yet been willing to file distribution tariffs. No one has even remotely suggested setting distribution tariffs below cost.
- B) APS has failed to demonstrate that they face any of the shareholder write-offs they allege (page 12, line 16). Regulatory assets are assured recovery by a previous Commission decision. The asset impairment test is a very different and much less punitive test than the write-off test for regulatory assets (FASB No. 71). APS has not presented any asset impairment calculations or results.
- C) APS' threat of higher interest costs at a time of very low interest rates is ridiculous. Virtually every new bond issuance or refinance must surely be at rates substantially lower than previously. APS has failed to demonstrate that its future interest rates on debt will increase relative to its embedded debt rates. The argument is irrelevant anyway.

In closing, APS' proposal is a major disappointment. APS has failed to comply with Commission Order No. 60977. Its filing should be rejected. APS's filing raises the very serious question of whether APS will take any significant step to encourage the development of a competitive market for electricity supply. It is now abundantly clear that APS has no intention of facilitating meaningful competition; regulatory coercion is necessary. The trust in APS' good faith evidenced by this Commission when it permitted APS early recovery of regulatory assets without requiring APS to undertake any steps to implement competition as a condition to their recovery was clearly misplaced. Unfortunately, it would appear that only punitive measures remain.

Respectfully Submitted, September 21, 1998.



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An original and ten copies filed today with:

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Distribution list for parties that intervened in the Stranded Cost hearing in which
Decision No. 60977 was issued.